CHAPTER 7

Budgeting: A Road Map for Sports Organizations

Chapter Objectives

- **Appreciate the need and value of financial planning.**
- **Understand the value and use of budgets.**
- **Define the different budget types.**
- **Understand what a pro forma budget is and why it is an important part of a business plan.**

Importance of Financial Planning

- **Financial planning can help provide appropriate solutions for the types of problems businesses face every day, such as the need to**
  - **develop new products,**
  - **spend more money on research and development,**
  - **borrow funds for future expansion,**
  - **issue more stocks,**
  - **issue more bonds,**
  - **sell existing assets,**
  - **purchase new assets,**
  - **move the business to another location,**
  - **acquire a competing company, and**
  - **file for bankruptcy protection.**

Determining Financial Objectives

- **The key will always focus on what the organization is trying to accomplish, and then what resources are being given to help accomplish these goals and objectives.**
- **Those resources are reflected in the budget.**

Benefits of a Budget

- **Assist in strategic planning.**
- **Anticipate potential future actions and results.**
- **Highlight what resources are needed and why.**
- **Highlight potential revenue shortfalls.**
- **Communicate future financial plans to key stakeholders (e.g., employees, management, stockholders, and government agencies).**
- **Assist management in monitoring spending.**
- **Help produce more accurate analysis and performance measurement.**

The Anatomy of a Budget

A budget is a road map that shows where the sport business intends to spend its money.

Example of Sport Budgeting

- **Going to a postseason football bowl game**
  - **Account for any potential transportation, housing, food, and related expenses**
  - **Include the cost of purchasing tickets to sell to fans**

Budgeting

- **In 2011, the University of Connecticut, as the Big East champions, were invited to play a New Year's bowl game against the Oklahoma Sooners.**
  - **UConn was able to sell only 4,600 tickets for around $646,000 against a guarantee of $3.35 million.**
  - **Only 2,771 of those tickets went to the general public, who paid from $105 to $255 per ticket.**
  - **UConn generated around $3.2 million from the game, but incurred $4.86 million in expenses, resulting in a loss of $1.66 million.**

University Athletic Department Foundation

Revenue and expenses for a sample collegiate athletic foundation are broken down in amounts and percentage of total funds for various categories.

Revenue	
Fund-raising and annual campaign (45.4%)	$3,220,266
Direct mail and telemarketing (27.2%)	1,936,589
Investment income (11.8%)	838,773
Program services (5.6%)	395,540
Game sponsors (5.2%)	366,930
Foundations and grants (3.0%)	215,007
Souvenir sales (1.8%)	126,895
Total revenue	**$7,100,000**

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University Athletic Department Foundation *(continued)*

Expenses	
Program services (52.8%)	3,742,385
Revenue development (17.6%)	1,252,106
Net asset increase (14.1%)	1,001,196
Direct mail and telemarketing (8.9%)	634,965
Management and general (6.6%)	469,348
Total expenses	**$7,100,000**

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University Athletic Department Foundation *(continued)*

- **These numbers tell the following stories:**
  - **More than 50% of all money raised helped pay for program services.**
  - **Investment income will increase on an annual basis if the athletic foundation continues increasing its net assets, because the primary assets are investment securities that will generate future income.**
  - **Only 6.6% of expenses were dedicated to managerial tasks, while 26.5% of expenses helped raise operating funds. Thus, over a quarter of the expenses were used to raise money.**
  - **Although direct mail and telemarketing costs were $634,965, this investment was very successful in helping to raise almost $2 million.**
  - **The greatest revenue source came from fund-raising efforts and donations by individuals to the annual campaign.**

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University Athletic Department Foundation *(continued)*

- **Based on these numbers, a budget could be developed that highlights possible additional anticipated revenue from programs that are doing well.**
- **Future expenses also might increase if there are priorities change or if additional expenses are anticipated for various activities.**

Budget Types

- **Operational budget**
  - **Reflects the day-to-day operations of the organization and lists sales and expenditures for normal operations**
  - **Comprised of other budgets such as a sales, production (often broken down with categories such as direct material, direct labor, manufacturing overhead, and variable cost budgets), and administrative expenses budget**
- **Capital/financial budget**
  - **Oriented more to the long term and often focuses on future expenditures such as spending for a new building or purchasing other major assets**

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Budget Types *(continued)*

- **Master budget**
  - **A comprehensive projection of how management expects to operate all aspects of the business over the designated budgetary period.**
- **Cash flow budget**
  - **Examines the inflows and outflows of cash on a day-to-day basis.**
- **Financial budget**
  - **Outlines how an organization spends and receives money across the entire organization.**

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Budget Types *(continued)*

- **Static budget**
  - **Shows expenditures which remain unchanged regardless of sales levels.**
- **Line-item budget**
  - **Every item is listed on a separate line with a corresponding amount associated with it.**
- **Performance budget**
  - **Explores what a goal might be for the organization, what the anticipated outcomes are, and how much it will cost to achieve these outcomes.**

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Budget Types *(continued)*

- **Zero-based budget**
  - **All expenses must be justified for each budgeting cycle or period.**
  - **Starts at zero.**
- **Pro forma budget**
  - **A future budget based on past financial results and expected future financial results.**

Basic Budget Types

Table 7.5 Basic Budget Types

Budget type	Explanation
Master budget	Provides an overall analysis of organizational revenue and expenses
Capital budget	Serves as a long-term financial plan
Operational budget	Shows the day-to-day operations of the organization
Cash flow budget	Examines the cash going in and out of an organization
Financial budget	Outlines how an organization spends and receives money
Static budgets	Examines fixed costs regardless of any change in revenues
Line item budget	Provides easier analysis with items listed on separate lines and the lines grouped together
Performance budget	Explores how set funds help achieve organizational goals
Zero-based budget	Forces every unit to prove the value of its expenditures

Developing a Pro Forma Budget

- A pro forma budget is simply a future budget based on past financial results and expected future financial results.
- It contains a financial plan for the business.
- The two are often combined to help complete the business plan.
- Typical extensive pro forma budgets might incorporate the following:
  - A sales budget
  - A promotion budget
  - A materials, labor, and overhead budget
  - A cash flow budget
  - A capital appreciation budget

A Financial Plan in Five Steps

1. **Develop a system of projected financial statements, which can help a company analyze how the operating plan will affect the projected profits.**
2. **Determine the funds that will be needed to help fund the long-term plans.**
3. **Forecast what funds will be available over the long term and how much of the funding will be generated internally and externally.**

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A Financial Plan in Five Steps *(continued)*

4. **Establish and maintain a system of controls governing how funds are allocated and used.**
5. **Examine the results and develop procedures for adjusting the plan if the forecasts are not met.**

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Financial Plan in Five Steps *(continued)*

Writing a Business Plan

- **The plan summary should be written after all other sections are finished. It describes the following:**
  - **The purpose of your plan**
  - **The product or service that you will sell and why it is unique**
  - **Second- or third-generation products or services to help maintain sales**
  - **The market potential**
  - **Specific highlights in the marketing plan**
  - **The skills provided by the management team**
  - **The financial projections for the first several years**
  - **Your funding needs**
  - **An exit strategy if the business does not succeed**

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Writing a Business Plan *(continued)*

- **Industry**
  - **Highlight the economics in the industry, industry trends, and potential legal or regulatory concerns.**
  - **Critically analyze the competitive forces you might face.**
- **Company**
  - **Review the history and background of the business. It can include the mission statement, objectives, goals (long and short term), and strategies.**
  - **List the current principal owner(s) or majority stockholder(s), all members of the board of directors (if applicable), and all key executives.**

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Writing a Business Plan *(continued)*

- **Special Circumstances**
  - **For example, what stock purchase options exist if the company goes public? Do key employees have noncompete contracts?**
  - **Any data an investor would need to make an investment decision should be included.**
- **Analysis of the Product or Service**
  - **Include a thorough analysis of the product's or service's unique qualities, which will help distinguish the product or service from those offered by competitors.**
  - **The plan should identify any ancillary products or services that also might be produced to develop a more significant product or service line.**

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Writing a Business Plan *(continued)*

- **Market**
  - **This section focuses on the demographic characteristics of the proposed market.**
  - **Who is the target market? What is its size? Can these people be reached? Do they have the funds necessary to purchase the product or service?**
- **Marketing Strategy**
  - **This section focuses on how to sell or distribute the product or service to potential buyers.**
  - **Apply the four Ps of marketing—place, product, price, and promotion. Sample brochures, advertisements, announcements, product packaging, product or service guarantees, and related materials should be included.**

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Writing a Business Plan *(continued)*

- **Operation**
  - **This section describes how the product will be developed and produced or how the service will be delivered.**
  - **It should discuss critical dates (e.g., when production will begin), as well as who will produce the products, where the inventory will come from, what shipping schedule will be followed, how the products will be delivered to clients, and so on.**
- **Management and Personnel**
  - **This part of the plan lists all the key people necessary for the business to be successful, with brief biographies of past accomplishments along with potential references.**

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Writing a Business Plan *(continued)*

- **Financial Projections**
  - **This section addresses when investors can expect to make their money back and what profit investors can realize.**
- **Capital Needs**
  - **What funds will be needed to launch the business? When will the funds be needed?**
  - **To help establish potential collateral, the plan should highlight what the funds will be used for.**
- **Miscellaneous**
  - **This part contains relevant pictures, price lists, facility diagrams, and necessary equipment, plus a discussion of any unusual risks.**

Characteristics of Successful Business Plans

1. **Clear and realistic financial projections are the most important element.**
2. **The plan contains detailed and documented objective market research.**
3. **The plan includes a detailed analysis of all competitors.**
4. **The plan demonstrates that the management team is more than capable of leading the company.**

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Characteristics of Successful Business Plans *(continued)*

5. There is a two- or three-page summary that includes critical projections such as income statements.
6. The plan provides proof of the writer's vision by clearly differentiating the product or service from that of the competition.
7. The document follows a clear plan and is written in proper English that is clear, precise, and free of grammatical mistakes.

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Characteristics of Successful Business Plans *(continued)*

8. **The most effective plans are short, rarely exceeding 40 pages. Documents longer than this can become too cumbersome to read.**
9. **The writer clearly explains the bottom line—why the money is needed and how investors will be repaid.**
10. **The writer has taken the time to make the plan their own. When people write business plans using their own words, instead of hiring an outside writer or using canned computer software, the reader has a better feel for their sincerity.**

Class Discussion Topics

1. **Discuss a rough budget for your personal finances. What hurdles might you face in preparing and following the budget?**
2. **What things can prevent a team from meeting its budget projections?**
3. **What is the value of budgeting?**
4. **Analyze the revenue and expense projections for a local college or university, and try to determine some of the potential financial objectives for the athletic department.**

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Class Discussion Topics *(continued)*

5. **What key items need to be documented so that a business can accurately analyze its financial performance?**
6. **What are some of the difficulties that can be encountered when trying to project the future profitability of a team-sport franchise?**
7. **Why is it advisable to use multiple scenarios to project the future financial profitability of a business?**